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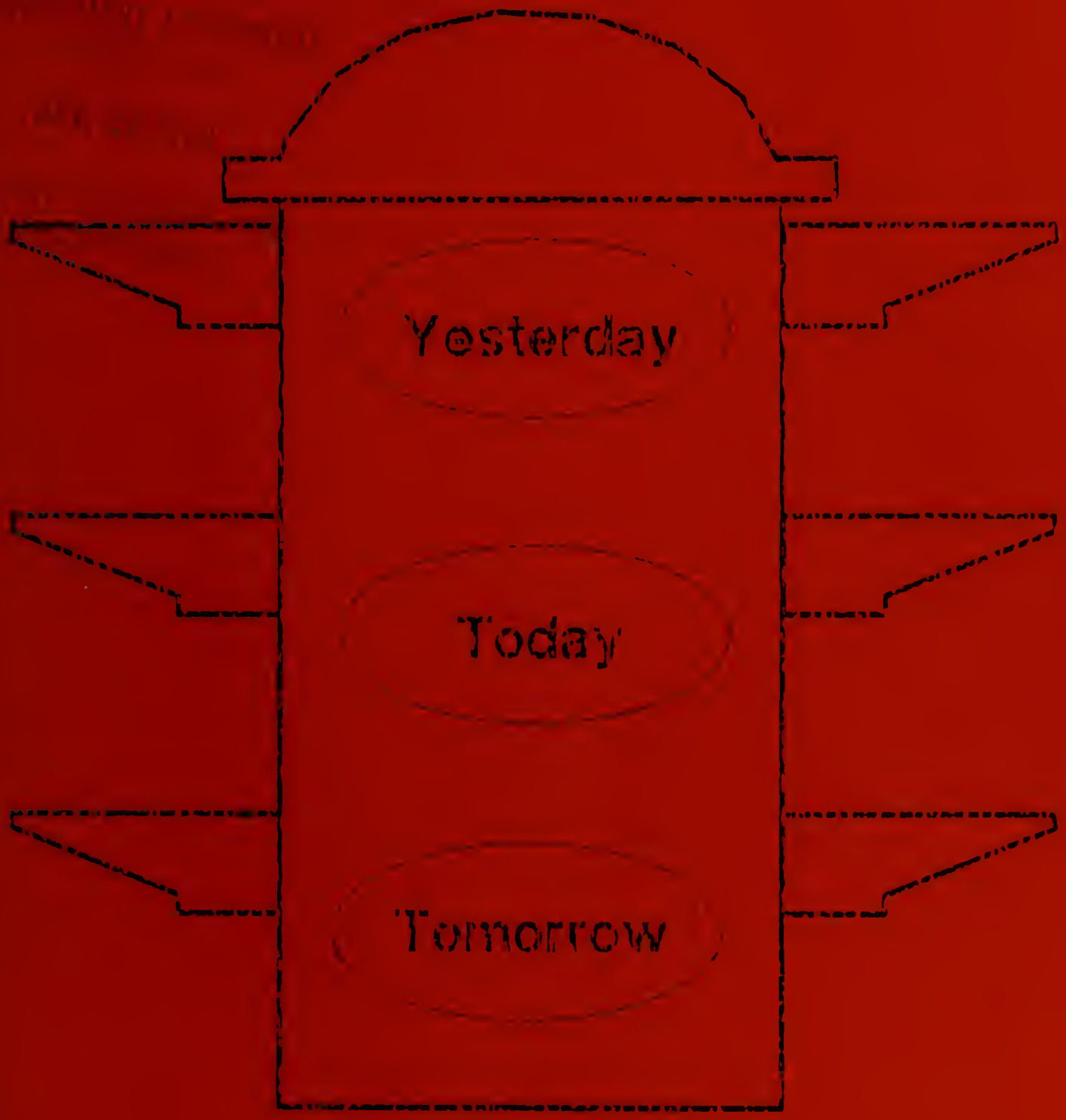
MASSACHUSETTS AUTOMOBILE INSURANCE



A Report Prepared by

the

Executive Office of Consumer Affairs & Business Regulation

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AUTOMOBILE INSURANCE IN MASSACHUSETTS:

YESTERDAY, TODAY AND TOMORROW

For over 60 years, Massachusetts has set its own path on automobile insurance, leading the way for other states or charting its own course. Now, at the beginning of 1988, it faces a new series of challenges: relatively high rates and rate increases, the highest level of insurance claims in the nation, losses prompting some insurers to pay millions of dollars to leave the state, and unhappy consumers. This report is an attempt to describe how Massachusetts' automobile insurance system evolved in the past, where we are today, and where we can be tomorrow.

I. General Background

A. The Current Automobile Insurance System in Massachusetts

There are approximately 4 million licensed drivers in Massachusetts and approximately 4.3 million registered motor vehicles.[1] Of those motor vehicles, 3.4 million are private passenger vehicles and .9 million are commercial, together with a small number of governmental vehicles. It is estimated that there may be as many as two percent to five percent unregistered motor vehicles in the Commonwealth. Generally, the registered motor vehicles are insured, with the principal exceptions being cases of fraud, or forgery, or cars which continue to be registered during the period between cancellation of a policy and either replacement of the policy or cancellation of the registration by the Registry of Motor Vehicles.

Providing insurance to these motorists is a $2 billion industry, employing thousands of people throughout the Commonwealth, with further employment generated in the nearly $1 billion body shop industry, and with indirect benefits to the health care industry and the legal services sector.

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[1] Other states in the Northeast--Connecticut, New Hampshire and Maine--similarly report more motor vehicles than drivers, while New York and New Jersey report somewhat fewer vehicles than drivers.

1. Who provides the coverage?

While there are more than 100 insurance companies able to write automobile insurance in Massachusetts, most of the coverage is written by relatively few companies. Ninety percent of the coverage is written by the top 25 insurers. The top ten companies, in terms of market share, write approximately 66 percent of the automobile insurance business.[2] The top five write 42 percent. Of the top ten, three are domestic companies, and seven are foreign (out of state). The largest national automobile insurance writer, State Farm Insurance, which has approximately 15 percent of the national market, writes virtually no automobile insurance in Massachusetts.

There are approximately 20,000 licensed brokers and 40,000 agents in the Commonwealth. Approximately 60 percent of the private passenger insurance is written through brokers or agents.

2. How the System Provides Coverage

Under Massachusetts law, with few exceptions, any consumer who owns a motor vehicle can obtain insurance through any broker/agent or from the major direct writing companies. Policies that insurers do not wish to write voluntarily can be written through Commonwealth Automobile Reinsurers ("CAR"), which uses approximately 25 major companies to write and service this "residual market." These companies are known as "servicing carriers." The broker/agent or the CAR servicing carrier must provide coverage, and the consumers can ordinarily have their applications for registration stamped by

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[2] A list of the top ten automobile insurance writers is attached as Appendix I.

the insurer or agent on the spot, upon payment of the required down payment. A direct writing company which is not a servicing carrier can decline coverage and refer a customer to a CAR servicing carrier, but such direct writing, nonservicing carrier companies represent a small fraction of the market.

The only reasons a CAR insurer can deny coverage to an applicant are:

1. The applicant or any person who usually drives the motor vehicle has failed to pay insurance premiums due or contracted during the preceding twelve months; or

2. Any person who usually drives the motor vehicle does not hold or is not eligible to obtain an operator's license.

In addition, collision, fire, theft or comprehensive coverage can be declined under the following circumstances:

1. Coverage on a vehicle customarily driven by or owned by person convicted within the most recent five year period of any category of vehicular homicide, auto insurance related fraud, or motor vehicle theft;

2. Coverage on a vehicle customarily driven by or owned by persons who have, within the most recent five year period, made an intentional and material misrepresentation in making a claim under such coverages;

3. Collision coverage on a vehicle customarily driven by or owned by persons who have been involved in four or more accidents in which such person has been deemed to be at fault in excess of fifty percent within the three years immediately preceding the effective date of the policy, or

4. Comprehensive or fire and theft coverages on a vehicle customarily driven by or owned by persons who have had two or more total theft or fire claims within the past three years.

Except for the small numbers of drivers who are in those categories, the major insurers must offer the mandatory and optional coverages described in Appendix II, and cannot exercise any "underwriting" decisions except for deciding whether to cede the risk to CAR.

From the consumers' point of view, as long as they make required premium payments, they have coverage.

The insurer receiving the application either directly or through an agent/broker can elect to retain the policy, or to cede it to CAR. On business that the insurer retains, the insurer realizes any profits or losses on that business. If the policy is ceded to CAR, the insurer continues to administer the policy and receives an administration allowance for doing so, but any profits or losses under the policy accrue to CAR.

On business that is ceded to CAR, all insurers share in the profits or losses, generally based on the insurer's adjusted share of the voluntary (nonCAR) market. The formula for sharing the losses, CAR Rule 11, contains provisions which give some cost advantage to newly-formed companies. As discussed in section IV.D below, CAR Rule 11 is the subject of considerable debate.

The consumer generally does not know whether her policy has been ceded to CAR. Under the so-called "Lane-Bolling" amendment, chapter 364 of the Acts of 1977, CAR rates cannot differ from nonCAR rates for the same risk. Since the rates to be charged are the same

whether the policy is ceded to CAR or not, the decision to cede a policy to CAR has no direct economic impact on the insured.

After the issuance of the policy, if the consumer does not pay the required premium, the insurer can cancel the policy. If the policy is cancelled, the insurer is required to notify the Registry of Motor Vehicles, which thereupon cancels the registration. The consumer is legally obligated to turn in the plates, and a "bounty" system is in effect to give cities and towns $200 of the $300 to $1500 fine imposed when local police prosecute a driver for driving without insurance. M.G.L. c.90, sec.34J. However, because the data flow is not fully automated yet, there are delays and uncertainties in enforcement. Moreover, in many cases, the consumer has obtained replacement coverage before the cancellation proceedings result in any action.

B. The Automobile Insurance Rate Setting Process

Massachusetts' system for setting automobile insurance rates is almost unique.[3] In 1925, when Massachusetts adopted the first compulsory automobile insurance law in the United States,[4] effective in 1927, the Commissioner of Insurance was given the authority to fix and establish the rates on the newly-compulsory coverages. In 1928, the Commonwealth had its first automobile

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[3] The only other state which fixes and establishes automobile insurance rates is Texas.

[4] Although many states adopted financial responsibility laws, it was not until thirty years later, in 1957, that another state, New York, enacted compulsory automobile insurance. Most states with compulsory automobile insurance adopted it in the 1970'and 1980's.

insurance crisis, during which the Commissioner resigned over the need for a substantial rate increase.[5] (A summary of the statutory development of the Massachusetts automobile insurance system is set forth in Appendix IV.)

Each year, by law, the Commissioner of Insurance must first determine, after hearing, whether competition is insufficient to assure that rates will not be excessive or so conducted as to be destructive of competition or detrimental to insurers' solvency.

In 1977, Massachusetts did briefly try to establish a competitive automobile insurance market. Rates in high-risk territories and rates for young drivers shot up dramatically, even though moderate increases and even decreases in rates were the norm throughout the state. The rate shock in certain urban territories doomed the 1977 "experiment" with competition to failure.

Some commentators now argue that the problem with the 1977 "experiment" was the lack of a transition period. They argue that a gradual move toward competition, with caps on annual rate increases,

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[5] The Commissioner of Insurance, Wesley E. Monk, had set rates for 1927 without firm statistical information. After the first statistics were developed, he announced rates for 1929 that included increases of 46 percent for Territory 1, which included Boston, Cambridge and surrounding towns. Governor Alvan T. Fuller told Commissioner Monk that the increase was not justified, and Commissioner Monk resigned. An acting commissioner then filed new rates, which lowered the Territory 1 rates by 11 percent.

would succeed where the 1977 experiment failed. However, evidence from other states suggests that competition will produce rate instability as well as enormous rate increases for young and urban drivers.

If the Commissioner finds competition to be insufficient, which he has done every year since the 1977 experiment, then he sets automobile insurance rates for all policies purchased or renewed during that year. The annual auto rate hearing is a lengthy and complex process. The parties to the hearing traditionally include the insurance industry, represented by the MARB (Massachusetts Automobile Rating and Accident Prevention Bureau), the Attorney General, the Division of Insurance's State Rating Bureau, the Independent Insurance Agents of Massachusetts and the Professional Insurance Agents of New England.

The parties file their rate recommendations and, during the hearing, extensive testimony is taken. The parties argue the issues and file extensive briefs. The Commissioner of Insurance then must evaluate all of the filings, exhibits and testimony, and produce rates which are required by law to be "adequate, just, reasonable and nondiscriminatory." Any party to the hearing, except the State

Rating Bureau, can appeal the Commissioner's decision to the Supreme Judicial Court.

An explanation of the ratesetting process, including some of the various factors which must be considered, is attached as Appendix III. The rates are generally based on statistical results reported for the year previous to the rate hearing (that is, 1986 results were used for the 1988 rates), and those results are adjusted for anticipated changes in claims and costs. Insurers are required to engage in cost containment efforts, and the rates may reflect decreases due to the absence of such efforts. M.G.L. c.175, sec.113B. Brokers' and agents' commissions are determined as part of the rates, and insurers' projected investment income and taxes are factored into the rates.

Once the average rates are determined, an adjustment is made to reflect the estimated CAR deficit for the upcoming policy year. This adjustment, which is required by statute, M.G.L. c.175, sec.113B, results in so-called rate flattening, which reduces the rates for inexperienced and urban drivers below what they would otherwise have to pay and increases the rates for drivers in lower rated territories above the rates they would otherwise have to pay. Insurer profitability on nonCAR business therefore is increased, to cover the expected losses for CAR that the insurers will have to pay.

C. Where does the premium dollar go?

Despite the huge volume of data and projections involved in the rate decision, as well as the data collected by CAR, it is not easy to describe with precision where the premium dollars go. In the rate case, the data show where the premium for a given rate year is

projected or intended to go, but actual results almost invariably differ from those projections. But by the time the actual results are known, the information is dated and new projections are needed.

Moreover, information is routinely kept for various reasons on a calendar year or accident year basis, or on a rate year basis, or on a fiscal year basis, each of which generates different figures which are not comparable with figures the other bases generate.

For that reason, estimation of where the premium dollar currently goes can only give general trends, not exact figures.

Looking at the rates as fixed and established for 1988, the rate decision envisions the following approximate projected figures for the 1988 rate year for private passenger motor vehicle insurance:

Total premium is estimated to be nearly $2.3 billion. Personal injury claims and claim-related expenses, including liability, underinsured and medical expense coverage, are projected to be approximately 23 percent of the total premium, with personal injury protection (PIP "no fault" benefits) slightly under an additional 3 percent. Property damage, collision, and comprehensive claims and adjustment expenses are approximately 54 percent of the premium, and substitute transportation constitutes approximately 1.4 percent. Agents' and brokers' commissions equal approximately 13.3 percent of the total, insurers' general expenses constitute 8.6 percent, and the state premium tax is 2.3 percent. The above percentages add up to about 105 percent of the premium, with the difference being made up by the insurers' projected net investment income.

In dollars, the claims[6] and expenses would be as follows:

Property damage, collision, comprehensive:		$1,237 million
Bodily injury	:	524 million
PIP	:	65 million
Substitute transportation	:	33 million
Insurers' general expenses	:	196 million
Commissions (and commission allowance for direct writing companies)	:	293 million
Premium tax	:	53 million
Total		$2,412 million

D. The Safe Driver Insurance Plan

Since the mid-1970's, Massachusetts has sought to have truly bad drivers pay more than the average for their class and have drivers with clean records pay less. The mechanism used is the Safe Driver Insurance Plan ("SDIP").

Under the SDIP, drivers are given points for moving violations and at-fault accidents. However, drivers are allowed their first minor moving violation without being given a point. If they have one or more points in the previous three years, they must pay surcharges on their auto insurance. In 1988, those surcharges range from $50

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[6] The insurance industry has asserted that the above claim figures substantially understate what the true level of claims will be, by as much as $200 to $500 million. The 1988 and 1987 rate decisions have been remanded by the Supreme Judicial Court. A decision on remand must be rendered within 45 days, pursuant to the Court's remand order.

for one point to $900 for eight or more points. The surcharge amounts are determined in the rate hearing.

The total amount anticipated to be collected from the surcharges set in the rate hearing is then allocated among drivers with no SDIP points and no moving violations, resulting in an average credit, in 1988, of $71.

About 12 percent of drivers pay surcharges; about 65 percent of drivers earn the credit. There is no surcharge for the first moving violation, but those drivers lose the credit.

If surcharges reflected the true risk of loss associated with drivers having four or more points, they would be higher, probably ranging from $350 to $1100. Because the surcharges are not at that level, good drivers are subsidizing bad ones, and the surcharged drivers are not profitable business for insurers.

Until now, surcharges have been set at somewhat depressed levels. If they became too high, it would probably encourage drivers to forego insurance and drive illegally--thus raising everyone's costs. However, it is open to question whether an overt subsidy of bad drivers by good drivers is in the public interest. Moreover, requiring higher, actuarially indicated rates to be paid to insurers might help to reduce the size of CAR and its deficit.

II. How Massachusetts Compares With Other States

A. How Massachusetts Automobile Insurance Rates Compare With Those of Other States

The states in the Northeast Corridor from the District of Columbia to Massachusetts have historically had automobile insurance rates higher than most of the rest of the nation, except Alaska. In the first half of the 1980's, Massachusetts ranked in the top five states in average automobile insurance premium, with average premiums generally lower than New Jersey and more or less comparable with New York State, but usually somewhat higher than Connecticut and Pennsylvania.

Comparative data compiled by A.M. Best Company indicates that Massachusetts had the fourth highest average premium in 1986. It was lower than New Jersey, Alaska, and California, but higher than all other states. The A.M. Best ranking of all fifty states is set forth in Appendix VIII.

The A.M. Best data may make Massachusetts rates seem relatively higher than they really are. Best's "average" is compiled by dividing total premiums by the number of cars registered, not the number of cars insured. This methodology inflates the relative average for states, such as Massachusetts, with a high percentage of insured vehicles and deflates the relative average for states with a low percentage of insured vehicles.

Average premiums or rates do not tell the full story. Individual premiums vary widely, depending on driving experience, territory, type of car, coverage selections, age and in other states, on sex. Averages, of course, do not take into account such

individual variables.

Also, although the average Massachusetts rate may be relatively high, Massachusetts does not have the very high rates that some drivers--in particular, young, urban drivers--pay in other states. To give an example of the range of individual rates, we compared the 1988 insurance rates for a typical insurance package in Boston with quotes for similar packages in five other cities: Brooklyn, New York; Hartford, Connecticut; Newark, New Jersey; Philadelphia, Pennsylvania; and Los Angeles, California.[7]

For an experienced driver in Charlestown with a safe driver credit, the typical package would cost $1,331.50. In Brooklyn, the same driver would pay $2,321, but $4,283 if he were assigned to the high-risk pool. In Hartford, he would pay $1,515 and in Newark, $1,219. In Philadelphia, he would pay $2,410, but $3,913 if he was assigned to the high-risk pool. In Los Angeles, he would pay $2,458.

An 18-year-old male in Charlestown would pay $2,183.50 for the same package. In Brooklyn, he would pay $4,106, but $5,888 if he were assigned to the high-risk pool. In Hartford, he would pay $3,673 and in Newark, $2,448. In Philadelphia, he would pay $6,572, but $9,841 if he were assigned to the high-risk pool. In

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[7] We used a 1987 model car with a 1987 list price of $10,000--$12,000. We used an insurance package with PIP, bodily injury liability limits of $100,000/$300,000, property damage liability limits of $15,000, uninsured/underinsured motorist coverage limits of $15,000/$30,000, medical payments coverage limits of $5,000, and comprehensive and collision coverages both with a deductible of $300. For other cities, we used Insurance Services Office (ISO) rates where available, and rates based on ISO loss costs where ISO rates were not available.

Los Angeles, he would pay $7,880.

Of course, rates in smaller cities, towns and rural areas are usually not at this extreme, either in Massachusetts or in the other states. The statewide average rate in Massachusetts for 1988 is far lower than the above Boston rates.

This does not mean that Massachusetts rates are low--they are not, in comparison to rates in most states outside the Northeast--and it does not mean that an 8.25 percent increase in our rates in 1988 is not a serious increase. It does show, however, that our controlled automobile insurance rating system can moderate the extremely high rates that insurance companies in other states impose on certain categories of "disfavored" drivers, such as urban or young drivers.

Our fix-and-establish rating system also means that when reforms are passed, any cost savings they generate will be directly passed through as savings to consumers. In purely competitive markets, such savings are not generally as predictable.

B. The Massachusetts Claim Rate

A major factor contributing to Massachusetts' high auto insurance rates is our claim rate which is among the highest in the nation. According to the Insurance Services Office, in 1986, the Massachusetts claim rate for property damage liability coverage[8] was the highest in the nation. It was 67 percent higher than the

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[8] Property damage liability coverage is the best for state-to-state comparisons because state law is the most uniform in this area.

national average; 18 percent higher than the District of Columbia, which was second, and 37 percent higher than Connecticut, which was third. A table of the ten highest states is set forth in Appendix V. No one factor is entirely to blame for Massachusetts' extraordinary claim rate. Rather, a number of factors contribute to the problem, including the accident rate, traffic density, various provisions in our auto insurance laws, theft rate, and fraud.

C. Accident Rate

Unfortunately, no reliable statistics are available concerning the number of automobile accidents (as opposed to the number of insurance claims) in Massachusetts. The only statistics record the number of accidents reported first by the parties to the police, and then by the police to the Registry of Motor Vehicles. These statistics do not cover all accidents and certainly not all claims.

D. Traffic Density

Traffic density in the Boston area has increased substantially in recent years. The Registry of Motor Vehicles reports that the number of passenger vehicles registered in Greater Boston increased nearly 10 percent between 1982 and 1986 and over 40 percent between 1970 and 1986.

E. Massachusetts Laws Cause Rates to be Higher

Massachusetts' high auto insurance rates are due, in part, to differences between the Massachusetts auto insurance laws and

those in other states.[9] Massachusetts requires drivers to purchase more coverages than other states, limits consumer choices, and limits the ability of insurance companies and insurance consumers to control costs. These laws make auto insurance more expensive.

1. Required Coverages

Although Massachusetts is like most other states in requiring drivers to carry auto insurance, Massachusetts requires drivers to purchase more coverages than most other states. An explanation of the various coverages available under the Massachusetts Auto Insurance Policy is set forth in Appendix II. A description of the key differences between Massachusetts' coverage requirements and those of other states follows.

a. Uninsured and Underinsured Motorist Coverage

Most mandatory coverage states require drivers to purchase only liability coverage--coverage to protect other drivers, pedestrians, and others' property. Those states allow each driver to decide whether or not to purchase insurance to cover himself.

Massachusetts, however, requires every driver to purchase coverage to protect himself in case he is injured by an uninsured driver. It is one of only nineteen states to do so. Massachusetts also requires every driver to purchase coverage to protect himself in case he is injured by an underinsured driver. Only thirteen other states mandate this coverage.

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[9] Appendix IX is a chart showing how Massachusetts compares with the other states on many of the key legal issues discussed below.

Compulsory underinsured coverage limits consumer choices. Prior to 1981, underinsured coverage was optional. At that time, less than 13 percent of Massachusetts drivers chose to buy it.

This compulsory coverage also increases what the consumer has to pay. In 1988, the total cost for the compulsory uninsured and underinsured coverage ("U coverage") will be over $74 million, more than the total cost of PIP benefits.

In recent years, the cost of the compulsory and optional U coverage has been increasing dramatically. In fact, since 1985, the cost of that coverage has increased more than any other coverage. It has nearly tripled. This compares with an overall average rate increase since 1985 of only 27.4 percent.

b. Stacking

Massachusetts also differs from most other states by requiring stacking of the U coverage. Stacking is the practice of combining or "stacking" coverages applicable to more than one car to pay for damages from a single accident. Take, for example, a driver who owns two cars: a Ford Mustang and a Dodge Aries. While driving the Ford Mustang, the driver is hit by an uninsured motorist. Under stacking, the driver would normally be able to collect not only the U coverage he purchased for the Mustang, but also the U coverage he purchased for the Aries. This would be true even if the Aries were at home in the garage at the time of the accident.

Stacking was created by a Supreme Judicial Court decision in 1985. The Court allowed stacking where multiple cars are insured on separate policies. Cardin v. Royal Ins. Co. of America, 394 Mass. 450 (1985). However, the Court recently ruled that

stacking is not allowed where multiple cars are insured on the same policy. LeCuyer v. Metropolitan Property and Liability Ins. Co., CA. No.4640, February 16, 1988. In the example above, if the Ford and the Mustang were insured on separate policies, the driver could stack. If they were insured on the same policy, he could not stack.[10]

Stacking is very confusing. Few consumers know that when they select $20,000 of U coverage for each of two cars on two separate policies, they are actually buying, and paying for, $40,000 of coverage for each of those cars. Also, few consumers know that they get twice as much U coverage if they insure their cars on separate policies than if they insure those cars on the same policy, even though the price for the U coverage is the same no matter how many policies they choose.

Stacking is also highly inequitable. Single-car families must pay for stacking even though they are unable to benefit from it. Stacking forces single-car families to pay more than they should, and thus allows multiple-car/multiple-policy families to pay less than they should. Stacking forces single-car families to subsidize multiple-car/multiple-policy families.[11]

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[10] The Court has also ruled that stacking is available only up to coverage limits of $25,000 per person and $40,000 per accident. Johnson v. Hanover Insurance Co., 400 Mass.259 (1987). This limitation does not affect most Massachusetts drivers. Most drivers purchase only the minimum limits of $10,000 per person and $20,000 per accident.

[11] Single-policy/multiple-car families also must pay for stacking even though they are unable to benefit from it.

Stacking also reduces consumer choices. All multiple-car/multiple-policy families must buy stacking whether they want it or not. For two-car/two-policy families, stacking effectively doubles the amount of U coverage that they must buy. The mandatory limits are $10,000 per person and $20,000 per accident ($10,000/$20,000). However, because of stacking, anyone with two cars on two policies in effect must pay for limits of $20,000/$40,000 for each car. For three-car/three-policy families, stacking triples the amount of U coverage that they must buy.

Because stacking expands coverage, it is expensive. Eliminating stacking would save approximately $20-$30 million in annual auto insurance premiums. This would allow those consumers who want extra coverage to buy it, and allow those consumers who do not want the extra coverage to save money.

c. Trigger

Massachusetts also uses a U coverage trigger that is unlike that used in most other states. Our trigger is both expensive and confusing. It provides that a driver hit by an uninsured or underinsured driver can collect the amount of his U coverage plus an unknown amount--the amount of liability coverage carried by the at-fault driver. M.G.L. c.175, sec.113L. In the case of an uninsured driver, that amount would be $0. In the case of an underinsured driver, that amount could be $10,000 or $50,000 or $100,000 or more.

Most other states use a simpler trigger which gives consumers a guaranteed recovery. It guarantees that accident victims will have available an amount equal to the U coverage they purchase.

Drivers who choose $10,000 of coverage will be guaranteed $10,000; drivers who choose $100,000 of coverage will be guaranteed $100,000. The recovery is not dependent on the unknown amount of liability coverage carried by the at-fault driver.

Our trigger is very confusing. Drivers cannot know how much U coverage to purchase because, at the time of the purchase decision, they do not know how much they will be able to collect. Because of our trigger, $10,000 of U coverage could result in a recovery of $10,000--if hit by a driver with no insurance--but could also result in a recovery of $110,000--if hit by a driver with $100,000 of insurance. The other trigger is much simpler and enables drivers to determine exactly how much coverage they should buy.

Our trigger is also expensive. Changing to the trigger used by most other states would reduce total annual premiums by approximately $30-$35 million. It would also reduce the price of the U coverage by approximately 50 percent. For the same price that now buys limits of $10,000 per person and $20,000 per accident, drivers would be able to buy limits of $20,000 per person and $40,000 per accident.

This change would increase consumer choice. Those drivers who wish to spend less on auto insurance would be able to cut their U coverage premium in half. Those drivers who wish to spend the same amount would of course still be able to do so. Because of the trigger change, those drivers would have twice as much coverage available if hit by a driver with no insurance, and somewhat less available if hit by a driver with a large amount of insurance.

d. Bodily Injury Liability Coverage

Although Massachusetts requires its drivers to purchase more coverages than other states, it does require lower coverage limits for the bodily injury liability coverage. Massachusetts requires coverage limits of $10,000 per person and $20,000 per accident. Similar states require more. For example, Connecticut and New York both require limits of $20,000 per person and $40,000 per accident. New Jersey requires limits of $15,000 per person and $30,000 per accident.

2. Autobody Repairs

Massachusetts uses a system of insurance reimbursement for autobody repairs that is not used by any other state. In 1988, Massachusetts insurance payments for auto property damage will approach one billion dollars, most of which goes to body and glass shops. We must consider whether our unique system has produced inflated repair costs.

Unlike every other state, Massachusetts prohibits insurance companies from paying their customers immediately and directly for the estimated cost of repairs under collision and comprehensive coverages. M.G.L. c.90, sec.340; c.175, sec.1130. Rather, insurance

companies are required to wait until all of the repair work is done and a completed work claim form is submitted to the company. Ordinarily, this results in the body shop submitting the completed work claim form, on which the customer has directed the insurer to make direct payment to the body shop. The insurer is then required by law to make payment to the autobody shop. M.G.L. c.90, sec.340.

Other states use a different system. The insurance company is free to estimate the cost to repair the damage and send a check directly to the insured for that amount. The insured is then free to shop for a lower price. If he can find a shop that will repair the car for less than the amount the insurance company has approved, he is free to keep the difference. Some argue that this incentive causes consumers to search for lower prices and brings repair costs down. Others claim that it encourages consumers to seek lower quality repairs.

Our completed work claim form system may facilitate the fraudulent practice of "burying" the deductible. The system is designed so that the insurance company pays the body shop for the fair cost of the repair less the consumer's deductible, and the consumer pays the deductible to the body shop. The higher the deductible the consumer selects, the less he pays for insurance coverage. However, some dishonest consumers and body shops may conspire to inflate the cost of the repair by the amount of the deductible. The insurance company then pays more than it should, and the dishonest consumer gets away without paying his deductible. This fraudulent practice leads to higher insurance costs for everyone.

Massachusetts law also prohibits insurance companies from referring consumers to a particular repair shop, or even from recommending such a shop. M.G.L. c.26, sec.8G. Only two other states prohibit referrals. Even if an insurance company knows that certain shops do better work and charge lower prices, Massachusetts law prohibits the company from recommending those shops to its customers. However, the Supreme Judicial Court has recently ruled that if a customer asks his insurance company for a body shop recommendation, the company may provide that customer with a list of recommended shops as long as it makes clear that the customer is not obligated to use one of those shops. Allstate Ins. Co. v. Auto Damage Appraiser Licensing Board, 399 Mass. 850 (1987).

Some believe that the prohibition on referrals leads to high repair costs. Insurance companies have no way to direct their customers to the lower-priced shops. Moreover, the body shops have no incentive to reduce their prices to attract a higher volume of business from insurance company referrals. Others claim that referral shops do not charge less than nonreferral shops.

In fact, Massachusetts consumers are increasingly faced with "balance billing" by body shops. The body shop is not satisfied with what it can collect from the insurer, so it bills the consumer for the excess, holding the car for leverage.

Some states that allow referrals require insurance companies to guarantee the work performed by their referral shops. New Hampshire uses this system. The consumer is free to go either to a referral shop or to some other shop of his choosing. However, if he selects the referral shop, the insurance company guarantees that

the shop will complete the job for the amount of the check it wrote to the consumer. The insurance company also guarantees the quality of the work performed by the referral shop. This guarantee requirement encourages insurance companies to refer their policyholders to high-quality shops and provides an additional benefit for consumers. Moreover, use of such referral shops can protect the consumer from balance billing.

3. Auto Glass Repairs

Massachusetts also has a unique and costly system for auto glass repairs. Unlike virtually every other state, Massachusetts prohibits insurance companies from offering deductibles for glass damage and prohibits consumers from buying deductibles. M.G.L. c.175, sec.1130.

The ban on glass deductibles reduces consumer choices. Most drivers rarely, if ever, file glass claims. However, Massachusetts law prevents them from saving money by purchasing a deductible.

The ban on glass deductibles also increases the number of glass claims. Since the insured need pay nothing to have his car windows replaced, he is encouraged to have them replaced when they suffer even the most minor damage.

Some glass shops actually encourage drivers to have glass work done by offering incentives. These shops offer a free tank of gas, a $25 payment, or even a free holiday turkey to drivers who have windshields replaced, but only when the replacement is covered by comprehensive insurance. The incentive for unnecessary repair work is obvious. The insured drives off with $25 or a full tank of gas or

a holiday dinner, the insurance company buys a new windshield, and the average consumer who seldom has a glass claim pays for it all.

4. Agents' Commissions

Massachusetts also has unusual rules concerning agents' commissions. In other states, the commission rate for agents is negotiated between each company and the agents with which it does business. Massachusetts is different. Here, the total dollar amount of commissions is set by the Commissioner of Insurance when he sets the annual auto insurance rates. M.G.L. c.175, sec.162D. For 1988, that dollar amount results in a commission rate of 13.3 percent. The companies doing business through agents must pay out in agents' commissions all of the money they collect from policyholders for those commissions. However, they are allowed to vary the amounts they pay to particular agents by plus or minus 10 percent of the standard commission. Direct-writing companies, which do not use agents, are allowed to keep the money allowed in the rates for agents' commissions. In 1986, use of this "agency company rule" for setting rates allowed direct writing insurers an estimated $42 million in such commission allowances.

Insurance agents help to make insurance available to urban drivers. Because of the flattening of the Massachusetts rates, the companies would prefer not to insure many urban drivers. While those companies that are CAR servicing carriers are prohibited from refusing insurance to any applicant (absent extraordinary circumstances), most have not chosen to locate offices in many urban neighborhoods. Agents, however, do have offices in those neighborhoods and make insurance more accessible to urban drivers.

Agents also perform other services such as explaining the various coverages to consumers. If more coverages are made optional and consumer choice expanded, the agents will be available to ensure that consumers make informed coverage decisions.

F. Theft Rate

Massachusetts leads the nation in automobile theft. According to the FBI's uniform crime reports for 1985, Massachusetts ranked first in both thefts per vehicle and thefts per capita. Tables of the top ten states in each category are set forth in Appendix VI.

In 1987, the Governor's Auto Theft Strike Force concluded a fifteen-month sting operation known as GOFAST. The operation produced over 100 state and federal indictments for auto insurance fraud, including instances of owners arranging for their cars to be towed and junked and then reporting the cars stolen to collect on the insurance, and similar types of fraud and abuse.

By all accounts, much of Massachusetts' reported theft and arson is due to such insurance-related fraud. Last year's voluminous indictments showed that having a car conveniently stolen and/or torched may be a problem in Massachusetts that cuts across geographic, class and age lines. Unfortunately, our system makes such activities relatively easy.

For one, an applicant bent on fraud can insure a used car without even showing it to the insurance company or broker. Even when the company asks that it be inspected, the consumer can ignore the request <u>and still have coverage</u>. Criminals have even insured "phantom" cars--cars that have been crushed or dismembered in chop

shops--and reported them stolen. Such "stolen" cars of course are never recovered, and the insurance company pays for a total loss.

Our title system, while it is generally effective, thus can be misused when a car is junked. The car may be sold for scrap or spare parts, but the title may live on for at least one more phantom car insurance claim.

New York requires used cars to be inspected before they can be insured. This "preinspection" program for used cars cut auto theft (or reported auto theft) dramatically in its first year of operation, while theft increased in surrounding states. Indeed, testimony at the hearing regarding the 1988 rates indicated that an enforceable preinspection program would be the single most effective step to control fraud.

Other states also regulate the junking of cars by issuing salvage titles when a car is reported as a total loss. This inhibits phantom car and chop shop activity.

Both provisions would strongly discourage fraud and theft in our system, at a cost far less than the amounts saved.

Although antitheft efforts are very important, it is easy to exaggerate the effect of auto theft on insurance rates. Auto theft claim payments account for only approximately five percent of annual insurance claim payments and expenses.

III. No-fault Insurance

A. No-fault Insurance in Massachusetts

In 1970, Massachusetts became the first state in the nation to enact a no-fault automobile insurance law. The law has been an unqualified success. It dramatically reduced auto insurance premiums and has caused more injured people to receive more compensation, more quickly, with much less money wasted on attorneys' fees and other transaction costs.

However, the system is badly in need of an update. The no-fault levels have not been increased since 1970, despite a fourfold increase in medical costs. The Massachusetts PIP benefit and tort threshold have fallen far below those in other states. As a result, both the savings and the benefits of no-fault have been eroded.

1. How No-fault Works

Massachusetts no-fault auto insurance contains two elements: the PIP benefit and the tort threshold. PIP stands for Personal Injury Protection. It is the benefit available to every injured Massachusetts automobile accident victim. It provides compensation for medical expenses, lost wages, and replacement services. It is available without regard to fault, without delay--usually within thirty days--and without the need for litigation. An accident victim need only submit his bills to his own insurance company and he receives speedy compensation. The PIP benefit is available to many injured people who would collect nothing under traditional, fault-based insurance, such as victims of one-car accidents or at-fault drivers. Since 1970, the PIP benefit has been $2000.

The tort threshold is the second element of no-fault. It prevents people with minor injuries from suing for pain and suffering damages. However, it does not affect the ability to sue for other types of damages such as medical expenses and lost wages.

The tort threshold measures minor injuries in two ways. First, it considers the amount of the medical expenses caused by the accident. If the medical expenses exceed a certain dollar amount--now $500--the tort threshold is met and the person is free to sue for pain and suffering damages.[12]

The tort threshold also considers the nature of the injury. A person injured in an automobile accident is free to sue for pain and suffering damages, no matter how low the medical expenses, if he incurs any of the following injuries: 1) loss of a bodily member; 2) permanent and serious disfigurement; 3) loss of sight; 4) loss of hearing; 5) a fracture. For example, a person who suffers a broken bone in an automobile accident is free to sue for pain and suffering damages even if his medical expenses amount to less than $500. The tort threshold also does not apply if the victim dies in the accident.

2. The Benefits of No-fault

No-fault has produced dramatic savings for Massachusetts drivers. From 1970 (when no-fault was enacted) to

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[12] The tort threshold considers the value of the medical care received, rather than just the amount of the bills received by the injured person. For example, if the injured person is a member of an HMO and needs to pay only a small fee for each doctor visit, the tort threshold considers the value of the care he received and not just the small amounts he paid.

1976, the average cost for compulsory bodily injury coverage decreased 43 percent. Taking inflation into account, the cost for that coverage was 63 percent lower than it would have been without no-fault.

In addition to saving money, no-fault has also produced other substantial benefits for drivers in Massachusetts and throughout the nation. In May 1985, the United States Department of Transportation published a study of the national experience with no-fault entitled Compensating Auto Accident Victims: A Follow-up Report on No-fault Auto Insurance Experiences. That study compared no-fault states to traditional insurance states and reached the following conclusions: First, no-fault causes significantly more accident victims to be compensated. Second, no-fault causes more money to be paid to accident victims. Third, no-fault compensates victims far more quickly. Fourth, no-fault causes a greater percentage of premium dollars to be paid to accident victims. Finally, no-fault reduces the number of lawsuits and has produced significant savings in court costs and other legal costs paid by the taxpayer.

3. The Effects of Inflation and the Need for an Update

Unfortunately, neither the PIP benefit nor the tort threshold has been increased since they were set in 1970. While those figures have remained constant, medical costs, as measured by the Boston Medical Index, have increased fourfold.

As a result, the PIP benefit pays for only 25 percent of the medical care it paid for in 1970. Also, the tort threshold keeps far fewer minor injuries out of the courts. Anyone familiar with today's

hospital and doctor costs knows how easy it is to reach $500 in medical bills.

Because of the failure to update the no-fault levels to account for medical inflation, Massachusetts drivers have lost the savings no-fault produced in its first six years. The same coverage that experienced a 43 percent cost decrease from 1970 to 1976, has experienced a cost increase in eight of the last ten years. In 1984 alone, the cost of the coverage increased by 20 percent and in 1987, it increased by 16.6 percent. The cost of the coverage increased by an additional 13.3 percent in 1988. The following chart sets forth the percentage change in the cost of bodily injury liability coverage for every year since no-fault was enacted.

Massachusetts Private Passenger Automobile
History of Statewide Average Rate Changes
Compulsory Coverage A (A-1 plus A-2)

1971	-15%	(mandated by legislation)
1972	-28%	
1973	- 2%	
1974	0%	
1975	-10%	
1976	+ 2%	
1978	+ 8%	(change from 1976 rates)
1979	+ 7%	
1980	+ 2%	
1981	+12%	
1982	+12%	
1983	0%	
1984	+20%	
1985	+ 4%	
1986	- 1.6%	(included anticipated effect of seat belt law)
1987	+16.6%	
1988	+13.3%	

The benefits and the savings that no-fault produced in the early 1970s cannot be recaptured without an update of the tort threshold and PIP limits. Opponents of no-fault allege that updating the system will not reduce rates, will not reduce claims, and will leave seriously injured people without the ability to recover their pain and suffering damages. These are the exact same claims that no-fault's critics raised eighteen years ago. Those claims proved

dramatically wrong in 1971, and they have no more validity today than they did then.

B. No-fault Insurance in Other States

After Massachusetts enacted no-fault auto insurance in 1970, states throughout the country followed its lead. Today, twenty-two states have no-fault auto insurance. Fourteen of those states are, like Massachusetts, "no lawsuit" no-fault states. That is, they each have both a PIP benefit and a tort threshold. The other eight no-fault states are "add-on" no-fault states. They each have a PIP benefit, but no tort threshold. Add-on no-fault is very expensive because it contains only the PIP benefit, which increases costs by increasing payments to accident victims, but not the tort threshold, which reduces costs by reducing litigation expenses such as attorneys' fees.

Because of the failure to update the Massachusetts no-fault laws, our threshold has become less effective than the thresholds in other states. Indeed, only three other states have thresholds that are as low, or lower, than our threshold. A chart setting forth the tort thresholds throughout the country appears in Appendix VII.

The Massachusetts PIP benefit of $2,000 is also far lower than that in other states. Only one state, South Carolina, has a lower PIP benefit. Most no-fault states have a PIP benefit of $15,000 or more. A chart setting forth the PIP benefits throughout the country appears in Appendix VII.

IV. CAR

A. The Need for a Residual Market

Commonwealth Automobile Reinsurers ("CAR") is the residual market mechanism for the Commonwealth, that is, it insures risks that insurance companies do not want to assume. Ordinarily, insurers make their money by assuming risks. Therefore, turning down business, refusing to write risks, usually results from one of four factors:

1. The risk cannot be priced profitably or is so unpredictable that it cannot be priced rationally.

2. The insurer lacks the capacity to take on a risk, or is allocating its capacity to another area.

3. Certain underwriting decisions may be institutionalized, such as being reluctant to assume the risk of urban or young drivers, or new automobile customers generally, regardless of any actuarial analysis.

4. The structure of the residual market itself may make it attractive for an insurer not to retain certain types of business.

Under rate regulation, particularly with rate flattening, some risks, particularly inexperienced and urban drivers, are not priced at a level which will generate a profit. Insurers would not ordinarily choose to write those risks at the regulated rate, because the rate would guarantee a loss. In addition, some risks are unpredictable--for example, new customers with no track record--so that insurers do not feel they can predict the anticipated losses. Given an option, they will not write such policies, except possibly at an elevated premium.

Insurers also have limited capacity to write business--they must have sufficient surplus to cover anticipated losses on the business they write. If one line of business is less profitable than another, an insurer may direct its employees or agents to write only the more profitable lines, so as to allocate its surplus most profitably. Withdrawal of companies from Massachusetts is an extreme example of such reallocation of surplus.

To avoid having large segments of the population being denied coverage, insurers have been compelled to issue coverage involuntarily. In an effort to make that process fair, all insurers are required to share in underwriting the losses of the involuntary "residual" market.

B. How CAR Operates

Every insurer which writes motor vehicle coverage in the Commonwealth is required to belong to the residual market mechanism, CAR.

CAR is governed by a Governing Committee representing insurers and insurance producers (brokers and agents), appointed by and subject to general supervision by the Commissioner of Insurance. CAR writes insurance through approximately 25 servicing carriers.

When an applicant for insurance goes to a broker/agent or major direct writing company, the application can be accepted by the agent's insurer (or the direct writer) as voluntary business or the applicant can be insured through CAR. The option is up to the voluntary insurer, and in most instances, the applicant will not know whether her policy has been ceded to CAR. The companies and brokers/agents are prohibited from disclosing the CAR cession or

treating the CAR-insured consumer differently.

Under the CAR plan of operation and rules, all the CAR business is pooled, and after the close of the year, CAR losses are totalled and generally distributed among all the insurers on the basis of their adjusted share of the voluntary market. Insurers are given credits for their own expenses and for brokerage commissions, as well as additional credits for servicing certain less desirable markets and for insurance written through exclusive representative producers. These credits can make some types of CAR business attractive to the more efficient servicing carriers.

Every licensed broker or agent writing automobile insurance in the Commonwealth is assigned to a servicing carrier, except in cases of agent fraud, license revocation, breach of contract or default in the payment of premiums. When an agent/broker has no company willing to do auto business with him voluntarily, the broker can write only through his CAR servicing carrier. Such brokers are called "exclusive representative producers." There are over 1350 exclusive representative producers in the Commonwealth.

When a servicing carrier withdraws as a servicing carrier or leaves the market completely, that carrier's policies and its brokers/agents have to be reassigned to other carriers. Until recently, that has been accomplished without a great deal of public turmoil, but representatives of the industry have indicated a belief that current servicing carriers are at or near their capacity and that any further withdrawals of servicing carriers will sorely tax the ability of the rest of the market to absorb the extra business.

C. Other States' Residual Market Mechanisms

The first American automobile insurance residual market mechanism was developed in New Hampshire in 1938. That type of mechanism, under which an insurance applicant who is rejected by one or more companies is assigned to a company randomly, based on the company's voluntary market share, was, and is, used by most states. For many years, Massachusetts used such a mechanism, the former Assigned Risk Pool. In an assigned risk plan, once a risk is assigned to a company, that company retains the premium and is responsible for the losses or gains from that risk.

In the 1970's the old assigned risk pool was changed, and the Massachusetts Motor Vehicle Reinsurance Facility was created. This was similar to plans in effect in a handful of other states. It was believed that the more centralized Facility could better control any perceived abuses--for example, excessive rejection of applications by insurers--and would be more efficient and less cumbersome for consumers. Under the Facility, every insurer had to issue a policy to any applicant, but the insurer had the option of ceding the risk to the Facility. All the risks ceded to the Facility were pooled, and the resulting losses were distributed among all the companies. Instead of "owning" the assigned risk, the company servicing the policy only shared in that policy's losses, along with all other insurers. This was a fundamental change--from risk sharing to loss sharing--which theoretically could have serious cost implications.

In 1984, CAR replaced the Facility. CAR, a hybrid type of Joint Underwriting Association, is similar to the systems in effect

in only a few other states. Under CAR, the number of companies able to "cede" was reduced to approximately 25. Those companies are called servicing carriers. As with the Facility, the collective CAR deficit is still assessed among the whole industry, so it remains a loss-sharing rather than risk-sharing mechanism. One of the principal reasons for the use of a JUA is to coordinate antifraud efforts in the residual market, as well as to control excess cessions.

D. CAR: Problems and Potential

CAR now occupies 54 percent of the private passenger market, a higher market share than any other state's residual mechanism. It reported a deficit of $596 million for the fiscal year ending September 30, 1987. It has servicing carriers who wish to cease serving the involuntary market, and it has been blamed for many of the problems of our current system. While some criticism of CAR's structure may be valid, some of the major problems for which CAR is blamed are merely symptoms of larger problems in the system.

Looking at the two problems most often associated with CAR--the half billion dollar deficit and its dominant market share--both are associated primarily with rate flattening and perceived general rate inadequacy, and are only marginally caused by CAR rules or practices.

When rates for one sector of the population do not generate enough premium to cover claims and costs for that sector, and rates for another sector generate profits, an insurer is likely to keep the profit-making business and cede the losing business to CAR. If there is little rate flattening--that is, all business is

priced to generate minimally acceptable profits--and the company has costs comparable to those used in the rate calculation, ceding business to CAR would be uncommon.[13] However, if much of the market is viewed as underpriced, and the insurer views its claims and costs as being higher than the losses used in the rate calculation, the insurer will cede more business until it reaches the point that it is keeping only so much of the business as it believes will be profitable. It should be borne in mind that if a company believes that a given class of business is priced so as to generate a marginal profit, the company would not cede the business. It is indicative of the perceived general inadequacy of the rates that, on average, the insurers view 54 percent of the market as generating losses.

The CAR share of the market should decline with any substantial movement toward perceived rate adequacy (perceived by the insurers.)[14] Moreover, the more that truly bad risks are fully priced and companies are allowed to retain the full cost of such policies, the less need companies will have to cede risks to CAR.

Some companies assert, however, that the CAR rules, specifically Rule 11,[15] aggravate the situation. Rule 11

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[13] Some ceding would always exist, however. Insurers, given an option, often cede young and urban drivers and drivers without a track record, even in states with competitive rating. However, such drivers do not compose anywhere near 54 percent of the market.

[14] This effect may not be immediate. In 1977, during the brief experiment with competitive rating, cessions to the Reinsurance Facility increased, despite the presence of rates that the insurers who set them must have viewed as adequate.

[15] That Rule was adopted in 1983 by unanimous vote of the CAR Governing Committee.

establishes the formula for allocating the CAR deficit among insurers, based generally upon the adjusted share of each company's voluntary market writings. The companies now challenging the Rule argue that it unfairly distributes the deficit, is unconstitutional, and discourages them from expanding their voluntary business.

Rule 11 establishes upper and lower limits (caps) on the amount by which a company's CAR deficit share can increase or decrease in any one year. The caps were five percent for 1984 (CAR's first year) and two and one-half percent for each year thereafter, through 1988. Thus, a company's share of the CAR deficit (subject to certain credits for writing undesirable business) cannot increase or decrease by more than two and one-half percent over the previous year, regardless of the change in the company's voluntary market share. For 1989 and beyond, the caps have been relaxed to permit a decrease or increase of five percent per year in a company's deficit obligations.

The CAR rule is designed to have a stabilizing effect on the market by preventing dramatic shifts in business, and it has been generally successful. It does this by discouraging a reduction in a company's market share by more than two and one-half percent per year (five percent beginning in 1989). By preventing abrupt shifts in the marketplace, the rule has been a major factor in discouraging companies from casually withdrawing from writing Massachusetts' auto insurance.

In addition, others claim that CAR's structure itself creates a disincentive to control claims losses. Since a company handling a CAR claim must pay its administrative costs out of its own

pocket, but only pays a small percentage of any claim payment, there may be an incentive to settle claims instead of investigating or disputing them. This would create upward pressures on costs, or rather could eliminate a strong downward pressure on costs that companies which could keep every dollar of reduced claims payments would exert. However, the Commissioner of Insurance has not found, in recent rate cases, any significant difference between companies' treatment of CAR and nonCAR claims. Moreover, the 1986 cost containment law has mandated cost containment pressures, although since it is based on "average" industry conduct, its effect is somewhat diluted.

V. Insurer Withdrawal

Three insurance companies, Peerless, Fireman's Fund, and General Accident have recently left, or announced their intention to leave Massachusetts. Together, these companies accounted for approximately nine percent of the Massachusetts auto insurance market. A fourth company, the Kemper Group, has indicated that it will leave the Commonwealth unless it is allowed to put all of its auto business into a separate mutual insurance company. The Kemper Group accounts for approximately 8.5 percent of the market.

These companies' concerns relate only to auto insurance, and not our insurance system generally. However, those that have left have been required to stop writing all lines of insurance in the state. Massachusetts law provides that if a company refuses to write auto insurance, and if that refusal is contrary to the public interest and is not required to protect the company's solvency, the company's licenses to write all other lines of insurance must be suspended. M.G.L. c.175, sec.22H. Peerless has brought suit in Massachusetts Superior Court appealing the decision of the Commissioner of Insurance to suspend its licenses to write other lines of insurance.

The companies that are leaving have not cancelled their existing policies. Rather, they have refused to renew policies as they expire, and have refused to accept new customers. To date, the drivers whose policies have not been renewed by one of the departing companies have been able to find insurance elsewhere. However, their policies have typically been ceded to CAR.

Companies leaving the Commonwealth must pay CAR for their share of the CAR deficit. Fireman's Fund paid $45 million in settlement of all of its obligations to CAR. Peerless, on the other hand, has brought suit in Federal District Court in New Hampshire challenging CAR's assessments. General Accident has been enjoined by the Massachusetts Superior Court from failing to abide by its obligations to CAR.

CONCLUSION: The Fundamentals of Reform

The Massachusetts automobile insurance system differs markedly from other states in that it denies consumers options that consumers in other states have; it creates rates under which truly bad drivers do not pay the actuarial costs of the claims that they generate; it is ineffective in preventing even "amateur" fraud; and it mandates the payment of unnecessarily high costs. Reform of the Massachusetts automobile insurance system should address each of these concerns.

Giving consumers more options should be the centerpiece of reform. Massachusetts drivers should not be deprived of their ability to choose appropriate deductibles on glass coverage or to choose how much underinsured coverage they want. Our system has hamstrung consumers, compelling them to pay, and pay heavily, for coverages they may not need or want, even for coverage they cannot ever use. The Massachusetts consumer should be given the choices that consumers have in virtually every other state.

Our widespread network of agents and brokers, as the front line of consumer information, should play an important role in reforms which broaden consumer choices, and the burden of full disclosure of

consumer options rightfully belongs as a part of the service for which agents and brokers are paid.

Reform also means having the truly bad driver pay rates that cover the damages bad drivers cause. Our Massachusetts system has good drivers paying more than their claims would justify, with bad drivers paying less. Ending this subsidy of bad drivers by good drivers is not only fair, it may ultimately motivate drivers to try harder to avoid reckless or careless driving habits. On the other hand, pricing insurance for drivers with bad records cannot be taken to extremes: if a large segment of the population is suddenly given rates that few can afford, the result may be a dramatic increase in uninsured scofflaws, with negative results for everyone. Moving toward full costing of bad driving should be phased in, and drivers who "clean up their act" and show an improved driving and claims record should be rewarded over time by being able to avoid the dramatic, phased-in increases.

Fraud and theft have no business in our system. We need strong antifraud, antitheft and antiarson provisions. A salvage title law and a used car preinspection program will make it harder on the fraud and the thief. By cutting off thieves' access to easy insurance money and to the chop shop we can help every honest citizen in the Commonwealth.

Finally, reform should eliminate unnecessary costs that are built into our system. Our no-fault law saved consumers hundreds of millions of dollars, but in 17 years it has been eroded by inflation. We can bring back those savings by updating our tort threshold and PIP benefits. Other costs, such as excessive repair

costs, need to be eliminated as well.

Much of this report has been critical of the Massachusetts automobile insurance system. There is much to criticize. But we do have a system which will guarantee that when savings are realized, the consumer will benefit. The recent cost control statute, M.G.L. c.175, sec.113B, has been effective in making insurers reduce unnecessary costs and payments. Likewise, agents' and brokers' commissions have already been controlled and limited as part of the rate process, and those controlled commissions are already reflected in the rates consumers pay.

Because we have a controlled system, we know that if further savings are to be realized, they can only be realized at someone's expense, whether it is body shops or glass shops, lawyers, insurance companies, agents, or one class of driver or another.

The options are limited, but that does not make the choices ahead any less difficult. Reform will not be easy, but the direction it must take is clear.

APPENDIX I

LARGEST AUTOMOBILE INSURERS

Ranked by Massachusetts Market Share (1986)

Name	Market Share	National Headquarters
Liberty Mutual	11.60	Boston
Travellers Insurance Group	8.28	Hartford, Conn.
Kemper Group	8.14	Long Grove, Ill.
Aetna Casualty	7.76	Hartford, Conn.
Allstate Insurance Group	6.73	Northbrook, Ill.
Hanover Insurance Group	5.03	Worcester
Commerce Ins. Co.	4.71	Webster
Commercial Union Insurance Cos.	4.70	Boston
Fireman's Fund Insurance Cos.	4.68	Novato, CA.
Sentry Insurance Group	4.45	Stevens Point Wisconsin

APPENDIX II

The Massachusetts Automobile Insurance Policy

The Massachusetts automobile insurance policy contains 11 coverages. Parts 1-4 are compulsory and the remaining parts are optional. A description of the various coverages follows.

COMPULSORY COVERAGES

Part 1: Bodily Injury to Others provides limits of $10,000 per person and $20,000 per accident for potential liability for bodily injury to others. This coverage applies only in Massachusetts.

Part 1 applies whether the car is being driven by the insured or by someone else with his permission. However, Part 1 never covers injuries to the driver of the insured's car or to guests in that car.

Limits higher than $10,000/$20,000 and coverage for guests and out-of-state accidents are available under Part 5.

Part 2: Personal Injury Protection pays for lost wages (75%), medical expenses and replacement services, up to $2,000. It covers the insured and guests in his car as well as pedestrians struck by that car in Massachusetts. The insured may exclude himself and the members of his household from this coverage.

Part 3: Bodily Injury Caused by an Uninsured or Underinsured Auto requires limits of $10,000 per person and $20,000 per accident. Higher limits are optional. The coverage protects the insured, members of his household, and guests in his car against losses from injuries caused by an uninsured auto, by a driver with inadequate insurance, or by a hit-and-run driver. In addition, the Uninsured

Auto coverage protects the insured and members of his household as pedestrians against injuries caused by hit-and-run drivers. Underinsured Auto coverage pays for medical treatment, lost wages and other damages for which the other driver's insurance is not adequate.

Part 4: Damage to Someone Else's Property pays for property damage caused by the insured or someone using his car with his consent. Limits of $5000 are required; additional limits are optional.

OPTIONAL COVERAGES

Part 5: Optional Bodily Injury to Others extends the coverage provided by Part 1. Specifically, it covers injuries caused by the insured in Massachusetts, in other parts of the United States, and in Canada. It will also pay for injuries to guests in the insured's car and for injuries to others caused by any person using his car with his consent.

Part 6: Medical Payments covers medical expenses, but not lost wages, for the insured and his household and guests in his car, once the Part 2 limits are exhausted.

Part 7: Collision insurance covers accidental damage to the insured's car no matter who was to blame for the accident. The cost of Collision coverage varies according to the value of the car, where it is garaged, and the operator classification.

Part 8: Limited Collision is similar to Collision coverage, but it will not pay for one-car accidents, accidents in which the insured is more than 50 percent at fault, or for accidents where the owners of the other vehicle or the other driver cannot be identified.

Part 9: Comprehensive coverage is for damages to the insured's car not caused by collisions--fire, theft, and vandalism losses, for example. Comprehensive coverage does not insure personal belongings in the car unless they have been made permanent parts of the automobile.

Part 10: Substitute Transportation pays up to $15 a day for car rental, taxicab fares and other transportation costs up to a limit of $450.

Part 11: Towing and Labor will pay up to $25 for towing and labor charges each time the car breaks down. The cost of replacement parts is not covered, and labor is covered only to get the car going again at the place of breakdown.

APPENDIX III

How the Rates Are Set

Each year's rate hearing is based on the actual claims experience of the most recently reported full year. For the 1988 rate year, for instance, the data for 1986, collected and compiled by CAR and filed in early 1987, formed the basis for the rate filings for each of the parties.

Once the base data have been collected and compiled, the "pure premium" for the rate year is determined. This amount is calculated starting from the actual reported losses for each coverage. These losses are adjusted to take into account several effects which are likely to change the loss levels, such as increased use of center-mounted rear brake lights and changes in the use of seat belts. These "loss pure premiums" are then adjusted for a "development factor" to account for expected claims which have not yet been reported or any pattern of over or under reserving. The loss pure premiums are then multiplied by a factor for changes in the average cost of claims ("severity") and for any projected change in the frequency of claims. After accounting for insurance company claim adjustment expenses, the loss component of the rates is calculated for each different type of coverage.

General company expenses and commission expenses are then calculated and added to the loss component, and adjustments are made to reflect the state's 2.3 percent premium tax and the insurer's investment income and federal tax liability attributable to the 1988 premium. The rates may also be decreased under M.G.L. c.175,

sec.113B, if the Commissioner finds an absence of required cost containment efforts by insurers.

The resulting average premium is adjusted for relatively minor effects due to so-called symbol drift, and any net gain or loss from the SDIP program, to produce the average rate for each coverage.

The average rate is allocated among territories and other classifications, such as age or type of car, on the basis of "relativities" which in recent years have more or less accurately reflected the actual loss experience in those territories and classifications.

The CAR loading in essence then calculates the amount that costs for CAR drivers exceed the average rates for their classes and territories, and spreads that cost equally over all classes and territories.

In the rate hearing, claim frequency and severity trends are the subject of rigorous dispute, and insurers have claimed that in recent years, the Commissioner's resolution of those issues has generated vast losses. One industry calculation estimates the cumulative losses for the industry in Massachusetts auto in the last five years at over $1.6 million. Although that figure is subject to serious dispute, it is indicative of the insurance industry's view of the inadequacy of the rating methodology.

In projecting claim frequency, the Commissioner has used a predictive methodology known as the "null hypothesis" at various times since 1976, including 1987 and 1988. Under the null hypothesis, the Commissioner refuses to assume that claim frequency will increase in the next year simply because it increased in the

prior year. Rather, he assumes that claim frequency will remain the same unless the parties identify specific reasons outside the claims data why frequency will increase or decrease. Such reasons include changes in gasoline prices, legislative changes, etc. The industry contends that the null hypothesis has consistently underpredicted the increases in claim frequency. They argue that, since the data show that frequency has been increasing, the Commissioner should assume that it will continue to increase in the future whether or not they can identify a reason for the increase.

The second methodology at issue concerns claim severity. As with claim frequency, the Commissioner must determine whether and how much claim severity will change in the next year. Possible indications include both external indices, such as the Consumer Price Index, and internal indices such as the Massachusetts claims data from prior years. Starting in 1984, former Commissioner Hiam considered both external indices and the claims data and afforded a 60% weight to the external indices and a 40% weight to the claims data. In recent years, the data has indicated that Massachusetts claim costs have been increasing at a higher rate than the external indices. The industry has argued that, therefore, the external indices should be ignored when setting Massachusetts auto rates.

APPENDIX IV

The Development of Massachusetts' Automobile Insurance Statutes

In 1925, Massachusetts adopted the first compulsory automobile insurance law in the United States, effective in 1927. At the same time, the Commissioner of Insurance was given authority to fix and establish automobile insurance rates on the newly-mandated coverages. Although many states have had financial responsibility laws, it was not until the late 1950's that any other state adopted compulsory automobile insurance. New York was the second state to do so, in 1957. Most states with compulsory insurance laws adopted them in the 1970's and 1980's.

From the 1960's on, automobile insurance was the subject of legislation in Massachusetts on a regular basis. The 1960's saw the enactment of a mandatory offer law, under which insurers were required to sell certain coverages to anyone who applied. In response to rising premiums in the late 1960's, the Legislature froze compulsory bodily injury liability rates for 1969 and 1970 at 1967 levels. St.1968, c.643. A decision by the Commissioner to apply that freeze to other coverages was reversed by the Supreme Judicial Court in 1969. Insurance Rating Board. v. Commissioner of Insurance, 356 Mass. 184 (1969).

1970 brought an innovation of national significance--the first no-fault law in the country, Chapter 670 of the Acts of 1970. In the years immediately after the passage of no-fault, personal injury claim levels dropped beyond even the proponents' expectations. The no-fault legislation mandated a 15 percent reduction, but the actual

reduction in claims greatly exceeded 15 percent. Bodily injury coverage premiums fell substantially. See Appendix VI.

A similar experiment with no-fault in the property damage area was not successful. St.1971, c.978, mandated "property protection insurance" comparable to personal injury no-fault protection, with every person insured under that coverage exempt from property damage liability lawsuits. It was effective on January 1, 1972. In the property damage area, the savings from limiting lawsuits were not as great, and the no-fault benefits proved to be so costly that in 1976, no-fault was replaced with compulsory property damage liability coverage. The mandated property damage liability coverage has proven to be one of the major cost factors in the rates from 1976 on.

1976 also saw other reforms intended to lower costs. A standard $200 deductible was imposed for property damage claims, a merit rating plan to surcharge bad drivers and give credits to good drivers was instituted, and new restrictions were imposed on salvage and junk yards.

In 1977, the Commonwealth engaged in an unsuccessful attempt to return to competitive rating. That attempt failed when rates for a small percentage of the public (primarily urban and inexperienced drivers) increased astronomically, even though rates for most drivers increased modestly, remained level, or fell.

The years 1979 through 1981 saw legislation that raised costs by doubling compulsory limits, creating impediments to competition among body shops, and mandating underinsured coverage.

In the last five years, most of the legislative changes have sought to decrease costs. In 1983, the standard deductible was

increased to $300 (c.241), antiarson provisions were added to M.G.L. c.175, sec.113O, and the minimum fine for driving an uninsured vehicle was raised from $100 to $300 (c.465). In that year, the former merit rating plan was changed into the current Safe Driver Insurance Plan (c.703), which has resulted in substantially improved collection of surcharges with resultant increases in safe driver credits.

In 1984, in an effort to streamline the Massachusetts Motor Vehicle Reinsurance Facility and to improve antifraud efforts, the Facility was replaced with Commonwealth Automobile Reinsurers ("CAR").

Chapter 806 of the Acts of 1985 created a "bounty" system, under which cities and towns receive $200 out of the fines imposed on drivers operating unregistered vehicles.

In late 1986, the Cost Containment Bill, chapter 622, required the Commissioner of Insurance to review insurers' programs to control costs and expenses. If such programs are inadequate, the Commissioner can adjust premium charges accordingly. For 1987 and 1988, this has resulted in enhanced cost containment efforts and in some rate reduction.

APPENDIX V

Claim Frequency

PAID CLAIM FREQUENCIES PER 100 CAR YEARS

PROPERTY DAMAGE LIABILITY

1986

1	Massachusetts	7.17
2	Washington, D.C.	6.09
3	Connecticut	5.25
4	New Hampshire	5.21
5	New York	5.19
6	Rhode Island	5.19
7	Missouri	5.17
8	Texas	5.06
9	Maryland	4.96
10	Illinois	4.90
	NATIONAL AVERAGE	4.28

APPENDIX VI

Auto Theft

STATE VEHICLE THEFT REPORT
PER 100,000 REGISTRATIONS

1985

1	Massachusetts	1,305
2	New York	1,147
3	Michigan	1,082
4	New Jersey	997
5	Rhode Island	993
6	California	904
7	Alaska	870
8	Illinois	857
9	Texas	782
10	Nevada	637

STATE VEHICLE THEFT REPORT
PER 100,000 POPULATION

1985

1	Massachusetts	864.8
2	Michigan	827.8
3	California	672.2
4	New Jersey	664.3
5	Rhode Island	652.9
6	Texas	608.0
7	Alaska	606.3
8	New York	599.1
9	Illinois	590.9
10	Oklahoma	566.5

APPENDIX VII

No-Fault

The Massachusetts tort threshold is lower than that in all but three of the other "no-lawsuit" states.

Tort Thresholds

Colorado	$2,500	Col. Rev. Stat. sec. 10-4-714
Connecticut	$ 400	Conn. Gen. Stat. sec. 38-323
Florida	verbal	Fla. Stat. sec. 627.737
Georgia	$ 500	Ga. Code of 1981, sec. 33-34-9
Hawaii	$6,000	Hawaii Rev. Stat. sec. 294-6[16]
Kansas	$ 500	Kan. Stat. sec. 40-3117
Kentucky	$1,000	Ky. Rev. Stat. sec. 304.39-060
Massachusetts	$ 500	Mass. Gen. Laws c.231, sec. 6(D)
Michigan	verbal	Mich. Comp. Laws sec. 500.3135
Minnesota	$4,000	Minn. Stat. sec. 65B.51
New Jersey	$1,500	or $200 N.J. Stat. sec. 39-6A.8
New York	verbal	N. Y. Ins. Laws sec. 5104
North Dakota	$2,500	N.D. Cent. Code sec. 26.1-41-08
Utah	$3,000	Utah Code sec. 31A-22-309

As the table indicates, several states have exclusively verbal thresholds. These thresholds are more restrictive than the Massachusetts threshold. Our threshold is a mixed monetary and

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[16]The Hawaiian tort threshold is set annually by their insurance commissioner at an amount which is larger than that which was paid in 90 percent of the previous year's "motor vehicle medical rehabilitation claims."

verbal threshold. It allows recovery of pain and suffering damages if <u>either</u> the associated medical expenses exceed a certain dollar amount <u>or</u> the claim falls within certain categories. Exclusively verbal thresholds preclude recovery of pain and suffering damages, regardless of the amount of medical expenses, unless the claim falls within those limited categories.

The Massachusetts PIP benefit is lower than that in all but one other no-fault state, including both no-lawsuit and add-on states.

PIP BENEFITS

Arkansas	15,000	
Colorado	129,925	
Connecticut	5,000	
Delaware	10,000	per person/$20,000 per accident
Florida	10,000	
Georgia	5,000	
Hawaii	15,000	
Kansas	16,180	
Kentucky	10,000	
Maryland	2,500	
Massachusetts	2,000	
Michigan	Unlimited	
Minnesota	30,000	
New Jersey	Unlimited	
New York	50,000	
North Dakota	15,000	
Oregon	29,570	
Pennsylvania	15,000	
South Carolina	1,000	
Texas	2,500	
Utah	14,000	
Washington	24,380	

APPENDIX VIII

AVERAGE AUTOMOBILE PREMIUMS

RANKED BY 1986 AVERAGE PREMIUM

A.M. BEST CO.

Ranking	State	Average Premium
1	New Jersey	603.55
2	Alaska	602.45
3	California	568.20
4	Massachusetts	555.55
5	Arizona	553.84
6	Nevada	549.55
7	New York	522.06
8	Louisiana	514.97
9	Pennsylvania	512.09
10	Maryland	506.34
11	Michigan	481.07
*12	Rhode Island	476.60
13	Connecticut	466.09
14	Washington, D.C.	463.13
15	Delaware	462.49
16	West Virginia	454.65
17	Hawaii	453.60
18	Georgia	449.95
19	South Carolina	449.74
20	Colorado	444.11
*21	Arkansas	433.75
22	Texas	425.96
*23	Illinois	418.67
24	Minnesota	416.98
*25	Missouri	403.49
26	Utah	396.78
27	Oregon	396.37
*28	Washington	393.86
29	Florida	386.93
30	Wyoming	383.57
*31	Virginia	381.02
32	New Mexico	378.17
33	Montana	372.96
*34	Wisconsin	372.76
35	Kentucky	369.37
36	Oklahoma	368.85
37	Vermont	363.97
38	North Carolina	362.36
39	Kansas	345.19
40	Idaho	344.30
41	Indiana	337.60

*42	Maine	332.83
43	New Hampshire	330.47
44	Ohio	327.01
*45	Nebraska	323.98
46	North Dakota	307.13
*47	Mississippi	297.25
*48	Tennessee	292.49
*49	Alabama	278.46
*50	South Dakota	255.77
*51	Iowa	243.95
	NATIONAL AVERAGE	440.58

* Indicates states which did not have compulsory auto insurance laws in 1986, according to the Insurance Information Institute.

APPENDIX 1X

COMPARISON OF MASSACHUSETTS WITH OTHER STATES

	Fixed & established Rates		Prohibits Body Shop Referrals		Prohibits Glass Deductible		Prohibits Direct Pay To Consumer		Mandatory Under-insured coverage		Compulsory BI Liability Lims.	JUA or Assigned Risk Plan		Average Premium (1986)
	YES	NO	YES	NO	YES	NO	YES	NO	YES	NO		JUA	ARP	
MASSACHUSETTS	Y		Y		Y		Y		Y		$10,000/20,000	JUA		$556
Alabama		N		N		N		N		N	N/A		ARP	$278
Alaska		N		N		N		N		N	$50,000/100,000		ARP	$602
Arizona		N		N		N		N		N	$15,000/30,000		ARP	$554
Arkansas		N		N		N		N		N	N/A		ARP	$434
California		N		N		N		N		N	$15,000/30,000		ARP	$568
Colorado		N		N		N		N	Y		$25,000/50,000		ARP	$444
Connecticut		N		N		N		N	Y		$20,000/40,000		ARP	$466
Delaware		N		N		N		N		N	$15,000/30,000		ARP	$462
Florida		N		N		N		N		N	$10,000/20,000	JUA		$387
Georgia		N		N		N		N	Y		$15,000/30,000		ARP	$450
Hawaii		N		N		N		N	Y		$35,000/None	JUP		$454
Idaho		N		N		N		N		N	$50,000/50,000		ARP	$344
Illinois		N		N		N		N	Y		N/A		ARP	$419
Indiana		N		N		N		N		N	$25,000/50,000		ARP	$338
Iowa		N		N		N		N		N	N/A		ARP	$244
Kansas		N		N		N		N	Y		$25,000/50,000		ARP	$345
Kentucky		N		N		N		N		N	$25,000/50,000		ARP	$369
Louisiana		N		N		N		N		N	$10,000/20,000		ARP	$515
Maine		N		N		N		N		N	N/A		ARP	$333
Maryland		N		N		N		N		N	$20,000/40,000	state fund		$506
Michigan		N		N		N		N		N	$20,000/40,000	JUA		$481
Minnesota		N		N		N		N	Y		$30,000/60,000		ARP	$417
Mississippi		N		N		N		N		N	N/A		ARP	$297
Missouri		N		N		N		N		N	N/A	JUA		$403
Montana		N		N		N		N		N	$25,000/50,000		ARP	$373
Nebraska		N		N		N		N		N	N/A		ARP	$324
Nevada		N	Y			N		N	Y		$15,000/30,000		ARP	$550
New Hampshire		N		N		N		N		N	N/A	reins. fac.		$330
New Jersey		N		N		N		N		N	$15,000/30,000	JUA		$604
New Mexico		N		N		N		N		N	$25,000/50,000		ARP	$378
New York		N		N		N		N		N	$10,000/20,000		ARP	$522
North Carolina		N		N		N		N		N	$25,000/50,000	reins. fac.		$362
North Dakota		N		N		N		N	Y		$25,000/50,000		ARP	$307
Ohio		N		N		N		N		N	$12,500/25,000		ARP	$327
Oklahoma		N		N		N		N	Y		$10,000/20,000		ARP	$369
Oregon		N		N		N		N	Y		$25,000/50,000		ARP	$396
Pennsylvania		N		N		N		N	Y		$15,000/30,000		ARP	$512
Rhode Island		N		N		N		N		N	N/A		ARP	$477
South Carolina		N	Y			N		N		N	$15,000/30,000	reins. fac.		$450
South Dakota		N		N		N		N		N	N/A		ARP	$256
Tennessee		N		N		N		N		N	N/A		ARP	$292
Texas	Y			N		N		N	Y		$20,000/40,000		ARP	$426
Utah		N		N		N		N		N	$20,000/40,000		ARP	$397
Vermont		N		N		N		N		N	$20,000/40,000		ARP	$364
Virginia		N		N		N		N		N	N/A		ARP	$381
Washington		N		N		N		N		N	N/A		ARP	$394
Washington,D.C		N		N		N		N			$25,000/		ARP	$463
West Virginia		N		N		N		N		N	$20,000/40,000		ARP	$455
Wisconsin		N		N		N		N		N	N/A		ARP	$373
Wyoming		N		N		N		N		N	$25,000/50,000		ARP	$384